Office of the Inspector General of the Department of Defense

Presentation to the Department of the Navy Financial Improvement Plan Kickoff Conference

November 4, 2004

Audit Preparation and Source Documentation

Constitution of The United States

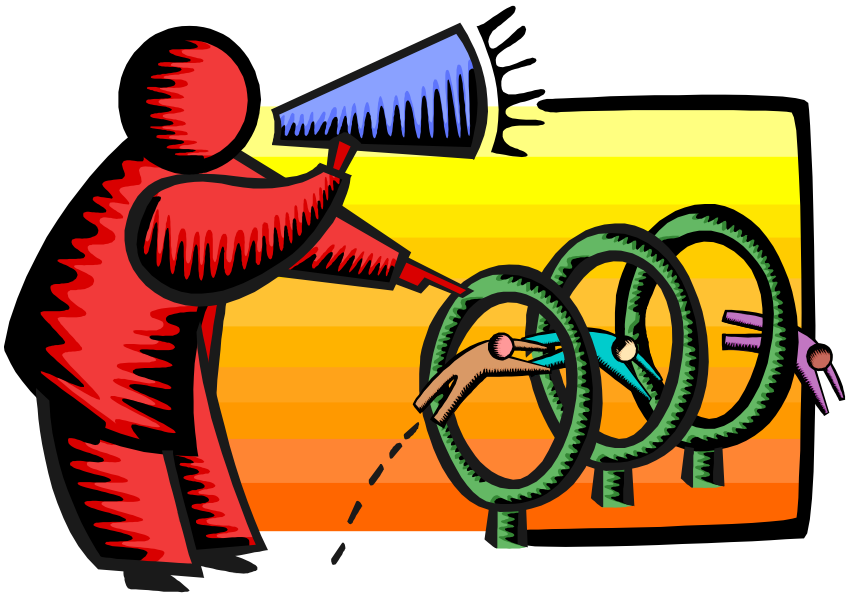
A Regular Statement of Account of the Receipts and Expenditures of all public Money shall be published from time to time.

Article I, Section 9

Financial Statement Audits

- For many organizations the word “auditor” sends a message of negativity and panic, however, the audit process can be virtually painless if you are ready and your staff is educated on the audit process.

Role of the Agency



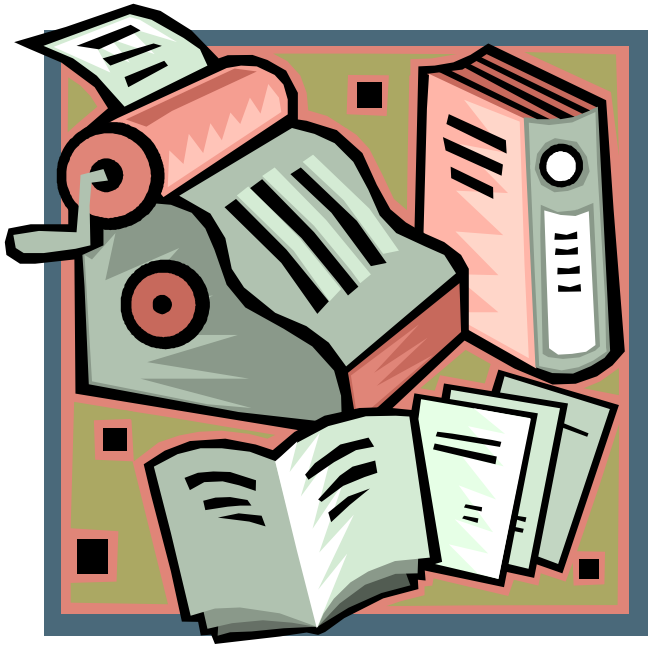
- Financial management occurs **throughout the year**, not just at year end.
- Communicate to everyone.
- Get buy-in from stakeholders.

Role of the Auditor

- Obtains an understanding of the agency's internal controls.
- Provides a listing (PBC) of items that will be required for the audit in advance of the start of fieldwork.
- Evaluates the reliability of supporting documentation related to the line items.

What is Source Documentation?

Evidence management will use to support assertions presented in the financial statements.



What is Required?

- Audits determine if balances and related notes presented in the financial statements fairly represent the operations of the entity.

  (Statement of Auditing Standards 31, Evidential Matter.)

- Assertions are representations by management that are embodied in financial statement components. They can be explicit or implicit and are classified in five categories.

Management Assertions

- Organization has sufficient audit-ready evidence to support financial statement balances as to
  - Existence and Occurrence
  - Completeness
  - Valuation or Allocation
  - Rights and Obligations
  - Presentation and Disclos

Management Assertions (cont.)

- Can the *existence or occurrence* be verified?
- Is information *complete*?
- Is the *valuation or allocation* of each item correctly reported?
- Does the entity have a *right* to the assets and an *obligation* for the liabilities?
- Is information properly *presented and disclosed* on the statements?

Existence or occurrence

- Recorded transactions, underlying events, and related processing procedures are authorized by federal laws, regulations, and management policy.
- Assets and liabilities exist at a given date and transactions have occurred during a given period.
  - Recorded assets of the entity at a given date are supported by appropriate detailed records.
  - Records are accurately summarized and reconciled to the account balance.

Completeness

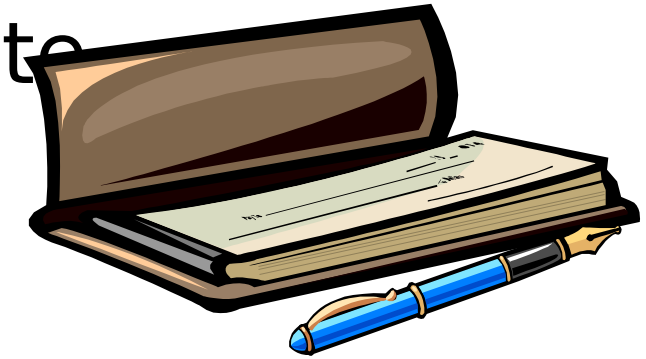
- All valid transactions are recorded and properly classified.
- All economic events that occurred in the current period are recorded in the current period.
- All accounts that belong in the financial statements are included. There are no undisclosed assets or liabilities.

Valuation or Allocation

- All transactions are recorded at the appropriate amounts.
- Assets and liabilities included in the financial statements are valued on an appropriate valuation basis.
- Revenue and expenses included in the financial statements are properly measured.

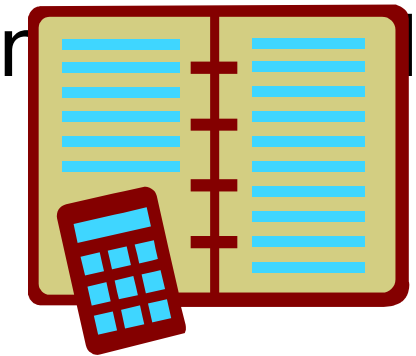
Rights and Obligations

- Recorded assets are owned by the entity as evidenced by legal title or similar signs of ownership.
- Assets are the rights of the entity at a given date.
- Liabilities are the obligations of the entity at a given date.



Presentation and Disclosure

- Accounts are properly classified and described in the financial statements.
- The financial statement components are based on accounting principles that are applied consistently from period to period.
- The financial statements or footnotes contain all information that is required to be disclosed.



Evidential Matter

- Evidential Matter requires that sufficient competent evidence be obtained through inspection, observation, inquiries, and confirmations to afford reasonable basis for an opinion regarding the financial statements being audited.
  - Evidence from independent sources provides more assurance than evidence secured solely from within the entity.

Evidential Matter (cont.)

- The more effective the internal control, the more assurance it provides about the reliability of the accounting data and financial statements.
- The auditor has to rely on evidence that is persuasive rather than convincing.

Characteristics of Evidence

- GAS 7.52 requires that the documentation be sufficient, competent and relevant
  - Sufficient – Enough documentation to support the client's assertion
  - Competent – Evidence is consistent with facts presented in the financial statements
  - Relevant – Logical relationship between evidence and financial statements

Evidential Documentation

Evidence	Existence & Occurrence	Rights & Obligations	Valuation	Completeness	Presentation & Disclosure
PHYSICAL					
Direct Inspection & Observation	X	X	X	X	
TESTIMONIAL					
Inquiries, Interviews, & Questionnaires	X	X	X	X	X
DOCUMENTARY (Samples)					
Relevant Laws & Agency Regulations	X	X	X		X
Documents of Public Record	X	X	X		X
Contracts, Agreements, Deeds, & Leases	X	X	X	X	
Certified Appraisals	X		X		X
Transfer & Shipping Reports	X	X	X	X	
Inventory Reports	X	X	X	X	X
Purchase Orders, Receiving Reports, Invoices	X	X	X	X	
Payment Vouchers, Checks or EFT #	X	X	X	X	
Maintenance Records	X		X		
System Reports & Client Prepared Schedules	X		X	X	

Availability of Evidence

- Record Retention
  - Guidance
    - NARA requirements
    - DoD Financial Management Regulation
    - Other Specific Guidance (i.e., SFFAS No. 6 for PP&E)
  - Assets and Liabilities acquired or incurred after a specified date
    - original documents and/or
    - hard and electronic copies of original documents

Availability of Evidence (cont.)

- Access to Client Prepared Documentation
  - Readily available
  - Provide access to consultants' work
- Absent Original Documentation
  - Underlying Accounting Data
  - Corroborating Information
  - Baselining Methodologies
    - Financial Community
    - Audit Community

Audit Trail

- Leave an Audit Trail!
  - Definition of Audit Trail: A continuous trail of evidence which links the individual transactions with the figures in the financial statements.
  - Source documents provide transaction details and include contracts & leases, amortization schedules, bills, invoices, time and attendance reports, travel vouchers, etc.

Benefit to the Client

- Prepares evidence of whether the financial records are presented in accordance with generally accepted accounting principles
- Saves Time
- Saves Money
- Increases accountability
- Ultimately – Unqualified Opinion